DIRECTIONS

for PERS Defined Contribution Retirement Plan Members

Montana Public Employee Retirement Administration (MPERA) **Fall 2003**

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Should any information in this newsletter conflict with statute or rules, the statute or rules will apply.

Inside this issue . . .

This is the first newsletter devoted to members of the Public Employees' Retirement System (PERS) Defined Contribution Retirement Plan (DCRP). The articles within this newsletter pertain specifically to your needs and the investment options within the DCRP.

Investment Options Annual Review

Each year, the Public Employees' Retirement Board (PERB), the Employee Investment Advisory Council (EIAC) and an independent investment consultant, review the investment options offered within your DCRP. The annual review ensures the DCRP provides appropriate investment options for our members.

The investment options are reviewed and analyzed against the benchmarks established in the PERB's adopted investment policy statement. The established benchmarks are:

- The fund rate of return for the most current three-year period must meet or exceed the 50th percentile of the Callan Associates universe of funds in the same asset class and investment category.
- The Sharpe Ratio Test for the most current three-year period must meet or exceed the 50th percentile of the Callan Associates universe of funds in the same asset class and investment category.
- The fund must receive a Morningstar Category rating of three stars (neutral) or higher for the most current three-year period.
- The fund's expense ratio must be no greater than the mean for the fund's peer group.

The investment options that fail to meet one or more of the established benchmarks or have a negative review in any of the below critical indicators may be placed in a watch status or discontinued.

In addition to the benchmarks, the following critical indicators are reviewed:

1. *Changes in fund manager or manager's style.*
2. *Changes in the fund class and category—for example, a small cap fund becomes a mid-cap fund or a value fund becomes a growth fund.*
3. *Changes in the fund's stated objectives.*
4. *Duplication with other investment options in the DCRP.*

See Page Three for Results of This Year's Annual Review

Automatic Rebalancing: Cruise Control for Your Portfolio

Automatic rebalancing programs provide participants with an easy-to-use management tool that can reduce portfolio volatility and improve performance.

Utilizing automatic portfolio rebalancing, like turning on an automobile's cruise control, is a simple process. By choosing a self-rebalancing investment option, a plan participant puts in place an automatic "buy low, sell high" discipline. To initiate auto-rebalancing, the participant selects a target asset mix and authorizes the plan provider to periodically restore the portfolio's mix to the target allocation. Once authorized, the plan provider monitors the portfolio and, through the automatic rebalancing process, is regularly selling shares of funds that have out-performed in order to purchase additional shares of funds that have lagged.

> "By choosing a self-rebalancing investment option, a plan participant puts in place an automatic "buy low, sell high" discipline."

Historically, auto-rebalanced portfolios have frequently outperformed their non-rebalanced, or "let-it-run" counterparts. Over the past 75 years, an automatically rebalanced portfolio of 60 percent stocks and 40 percent bonds would have outperformed its non-rebalanced counterpart in 17 of the 25 consecutive three-year periods[1,*].

(Re)balancing risk

While automatic rebalancing often has the potential to produce higher returns, it primarily acts as a risk management tool, enabling participants to set and maintain a consistent asset allocation.

The difference in risk between auto-rebalanced and non-rebalanced portfolios can be striking. Consider, for example, a non-rebalanced portfolio that began in 1995 as a blend of 60 percent stocks and 40 percent bonds. Left untouched through the bullish 1995-1999 period, the non-rebalanced portfolio's stock holdings would have grown to 79 percent of the portfolio — a much more aggressive mix.

As the 2000s unfolded and stock prices declined, the non-rebalanced portfolio would have been hit with a double-whammy. Its large 79 percent stock allocation would have felt the brunt of the bear market square-on, and only its small 21 percent bond allocation would have participated in the fixed income rally. As a result, the non-rebalanced portfolio lagged the rebalanced portfolio by 5.1 percent annually during the 2000s, and by 0.6 percent annually since 1995[2].

Motivated by similar experiences, many of today's investors are increasingly interested in getting the most from risk management tools such as automatic portfolio rebalancing.

Rebalancing opportunities are maximized when the portfolio contains several assets that have low correlations to one another. Low-correlated assets tend to move independently, providing the investor (or rebalancing program) with numerous opportunities to sell one asset and buy another. Stocks and bonds are examples of assets that have historically had low correlations, thus providing good diversification.

Maximizing the benefits

The relative benefit of rebalancing can vary with market conditions. In a volatile market with no apparent trend or direction, rebalancing has the potential to add significantly to a portfolio's return by repeatedly buying low and selling high. During this type of market, the more frequently the portfolio is rebalanced, the greater the expected benefit.

Rebalancing can also perform well in gradual up-down market cycles. As prices gradually rise, the auto-rebalancing program periodically sells to lock in capital gains, thus reducing downside risk. As prices reverse and enter into a declining phase, the rebalancing program purchases assets at progressively lower prices.

Automatic *Rebalancing* (continued)

During this type of gradual market cycle, the *less* frequently the portfolio is rebalanced, the greater the expected benefit.

However, automatic rebalancing is unlikely to perform well in one-way markets. During a servere and relentless stock market slide, for example, a rebalancing program would repeatedly sell bonds in order to reallocate to ever-declining stocks. If stocks failed to recover during the participant's investment horizon, the automatically rebalanced portfolio would underperform its non-rebalanced counterpart. An investor who is highly risk-averse or has a relatively short investment horizon might consider manual rebalancing as a viable alternative.

Regardless of market conditions, by offering an auto-rebalancing feature, plan sponsors can provide participants with an easy-to-use tool to manage risk.?

[1]Based on S&P 500 Index and Ibbotson Associates' U.S. Intermediate Term Government indexes, using quarterly rebalancing. Three-year performance periods from Q2 1928 through Q1 2003.

[2]Data through March 31, 2003. Quarterly rebalancing.

*Past performance is not a guarantee of future results.

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The Defined Contribution Investment Options

As a result of this year's annual review, the PERB is making the following investment option changes:

Investment Option Changes for DCRP

Discontinued Funds	Added Funds
MSIF Trust Mid Cap Value	Janus Mid Cap Value Investors (replaces the MSIF Trust Mid Cap Value)
SEI Institutional Small Cap Value A	Hotchkis & Wiley Small Cap Value A (replaces the SEI Institutional Small Cap Value A)
	Oakmark International I (new international value fund)

These new funds became available to *all participants on Wednesday, September 10, 2003.*

The discontinued investment options will close to *all participants on Tuesday, December 16, 2003.*

Participants have until 2:00 p.m. MST on Tuesday, December 16, 2003 to transfer their money from the discontinued investment options to other investment options within the plan. Money remaining in discontinued investment options after 2:00 p.m., Tuesday, December 16, 2003, will automatically transfer to the plan's default investment option—the Vanguard Balanced Index Fund.

You may wish to contact BenefitsCorp Account Executives to review your account and asset allocation.

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Telefax: **406-449-3306**

To Make Investment Option Changes, you may use:

***Key Talk: 1-877-699-4015. You may use the voice response system or talk to a customer service representative during normal business hours or,**

***The Web Site: http://www.MPERAdcplans.com**

TRANSACTION FREEZE PERIOD

When investment options are discontinued or changed, a **transaction freeze period** must occur. The transaction freeze period allows for the transfer of funds remaining in discontinued investment options and the reconciliation of transfers and investment options. The transaction freeze period ensures the integrity of the transfers, the system and your account balance.

Starting at 2:00 p.m. MST on Tuesday, December 16, 2003, the BenefitsCorp systems (KeyTalk and the website) will close to inquiries and transactions from all participants. The systems will re-open on Thursday, December 18, 2003.

Retirement Board Sets MPERA Administrative Fee

At their July 24, 2003 meeting, The PERB decided upon the following MPERA administrative fee.

75 basis points or ¾ of 1% annually (18.75 basis points per quarter).

This fee is necessary to pay the MPERA's expenses for administering the Defined Contribution Retirement Plan (DCRP). The fee will be assessed and deducted quarterly from your DCRP accounts and shown as a specific amount on your quarterly statements.

The PERB will monitor the fee to ensure:

1) it will cover MPERA's administrative expenses, and
2) it is equitable to all DCRP participants.

The fee will be modified by the PERB as needed.

The following chart shows fee examples based on various account balances.

Reminder: You are also responsible for the following fees:

Investment Management Fee

- Each of the investment options charge an expense ratio for their services. All expense ratios are disclosed in each investment option's prospectus and are netted from the declared rate of return.

Great-West Life & Annuity Insurance Company Recordkeeping Fee

- The fee is $73 annually or $18.25 per quarter.

Account Balance	Quarterly MPERA Fee	Annual MPERA Fee
$1,000	$1.88	$7.50
$5,000	$9.38	$37.50
$10,000	$18.75	$75.00
$25,000	$46.87	$187.50

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